

Update

Banking and Finance Law

February 15, 2007

The New Securities Transfer Act

The *Securities Transfer Act, 2006* (Ontario) (the “STA”) and related amendments to the *Personal Property Security Act* (Ontario) (the “PPSA”) came into force as of January 1, 2007. The STA modernizes commercial law in Canada by implementing new rules governing property rights that exist whenever securities are bought, sold or used as collateral. It is intended to accommodate modern securities settlement systems where securities are held indirectly through intermediaries in centralized securities depositories and where computerized book-entries are relied upon for settlement.

Alberta has passed virtually identical legislation and the other provinces are expected to follow suit with similar legislation in the next year or so, with the aim of implementing uniform securities transfer laws across Canada. The new rules in Ontario and Alberta have been based on Revised Article 8 of the U.S. Uniform Commercial Code.

The STA and the related changes to the PPSA will have a significant impact on commercial practice and on the use of securities as collateral for loans, derivatives and other financings. Among other things, the new regime:

- Creates a new form of investment property called a “securities entitlement” to capture the bundle of property and contract rights related to the financial assets within a securities account held by an intermediary or broker;
- Establishes new PPSA priority rules for investment property: a secured party who has “control” now trumps a secured party who has not established control and a securities intermediary with a security interest in a securities entitlement created by it may have priority over other secured

parties, unless the intermediary agrees otherwise;

- Uses the concept of “control” as the modern equivalent of possession of a negotiable certificate under existing law. In most cases, obtaining control in the direct holding system (certificated securities are issued directly from the issuer to the investor) will be much simpler than doing so in the indirect holding system (a securities intermediary such as CDS or a bank acts as custodian holding “financial assets” in a securities account for the benefit of its investor customer) where a securities account control agreement will likely be required; and
- Sets out new conflict of laws rules in the PPSA.

How Does the STA Affect You?

On a very basic level:

- Banks, financial institutions and other secured lenders will need to update their pledge documentation and put into place new due diligence procedures to ensure that they understand who may have, and how to properly obtain, control over pledged securities. They will also need to consider procedures and documentation for securities account control agreements.
- Securities brokers and securities intermediaries will need to prepare for negotiations of securities account control agreements and understand what additional obligations this may impose upon them. They will also need to update their customer account documentation to reflect concepts set out in the STA.
- Borrowers should be prepared for additional due diligence and documentation where security for the loan includes securities or securities entitlements.

Transitional Rules

The STA provides a four month transitional period from January 1, 2007 to ensure that previously perfected security interests remain perfected under the new rules.

Goodmans^{LLP} Update

While the STA and the related amendments to the PPSA are complex, they are welcomed because they will provide greater certainty to market participants by recognizing current practices in the securities industry.

Please contact any of the Goodmans lawyers listed below to discuss STA issues relevant to your business.

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